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Nos. 14-840, -841

# In the Supreme Court of the United States

FEDERAL ENERGY REGULATORY COMMISSION,
*Petitioner*,

v.

ELECTRIC POWER SUPPLY ASSOCIATION, ET AL.,
*Respondents*.

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ENERNOC, INC., ET AL.,
*Petitioners*,

v.

ELECTRIC POWER SUPPLY ASSOCIATION, ET AL.,
*Respondents*.

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*On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit*

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## JOINT STATES' BRIEF ON THE MERITS

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## QUESTIONS PRESENTED

1) Whether the Federal Energy Regulatory Commission reasonably concluded that it has authority under the Federal Power Act, 16 U. S. C. §§ 791a *et seq.*, to regulate the rules used by operators of wholesale electricity markets to pay for reductions in electricity consumption and to recoup those payments through adjustments to wholesale rates.

2) Whether the Court of Appeals erred in holding that the rule issued by the Federal Energy Regulatory Commission is arbitrary and capricious.

## TABLE OF CONTENTS

QUESTION PRESENTED i

TABLE OF AUTHORITIES iv

INTRODUCTION 1

STATEMENT OF THE CASE 3

SUMMARY OF ARGUMENT 3

ARGUMENT 8

I. FERC'S RULE PROPERLY EXERTS JURISDICTION OVER WHOLESALE DEMAND RESPONSE 8

A. FERC Possesses Authority Under FPA Sections 205 and 206 to Regulate Wholesale Demand Response as a Practice Affecting Wholesale Rates 8

B. FERC's Rule Does Not Directly Regulate Retail Sales 12

C. The Majority's "No Limiting Principle" Argument Is Misguided 19

II. *CHEVRON* ANALYSIS SUPPORTS FERC'S CONCLUSION THAT IT POSSESSES JURISDICTION PURSUANT TO THE FPA OVER WHOLESALE DEMAND RESPONSE 21

A. Demand Response Does Not Unambiguously Constitute a Retail Product Under the FPA 21

B. The Majority's Decision Inappropriately Creates the Risk of a Regulatory Gap 29

III. REMOVAL OF DEMAND RESPONSE FROM WHOLESALE MARKETS WILL IMPOSE PROFOUND NEGATIVE IMPACTS ON CUSTOMERS 32

A. Restructured States Rely on Demand Response in Wholesale Markets to Provide Meaningful Price Signals to End-Users 33

B. States Rely on Demand Response to Meet Environmental and Policy Goals 36

IV. FERC'S DECISION REGARDING DEMAND RESPONSE COMPENSATION IS NOT ARBITRARY AND CAPRICIOUS 39

CONCLUSION 42

## TABLE OF AUTHORITIES

### CASES

*Automated Power Exchange, Inc. v. FERC*,
204 F.3d 1144 (D.C. Cir. 2000) 28

*Cal. Indep. Sys. Operator Corp. v. FERC*,
372 F.3d 395 (D.C. Cir. 2004) 6, 19

*Chevron U.S.A. v. NRDC*,
467 U.S. 837 (1984) *passim*

*City of Arlington v. FCC*,
133 S.Ct. 1863 (2013) 22, 28, 29

*City of Cleveland v. FERC*,
773 F.2d 1368 (D.C. Cir. 1985) 10, 21

*Conn. Dep't of Pub. Util. Control v. FERC*,
569 F.3d 477 (D.C. Cir. 2009) 13, 14, 15

*Conn. Light & Power Co. v. Federal Power Comm'n*,
324 U.S. 515 (1945) 13

*Elec. Power Supply Ass'n. v. FERC*,
753 F.3d. 216 (D.C. Cir. 2014) *passim*

*F.C.C. v. Fox Television Stations, Inc.*,
556 U.S. 502 (2009) 42

*FDA v. Brown & Williamson Tobacco Corp.*,
529 U.S. 120 (2000) 29

*Federal Power Comm'n v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1 (1961) 31

*Gulf States Util. Co. v. FPC*,
411 U.S. 747 (1973) 31

*Mayo Foundation for Medical Educ. and Research v. U.S.*, 562 U.S. 44 (2010) 28

*Municipal Light Boards of Reading and Wakefield, Mass. v. Federal Power Comm'n*, 450 F.2d 1341 (D.C. Cir. 1971) 32

*Nat'l Ass'n of Regulatory Util. Comm'rs v. FERC*, 475 F.3d 1277 (D.C. Cir. 2007) 18

*New York v. FERC*, 535 U.S. 1 (2002) 27, 31, 33

*Niagara Mohawk Power Corp. v. FERC*, 452 F.3d 822 (D.C. Cir. 2006) 13

*Panhandle Eastern Pipe Line Co. v. Pub. Service Comm'n*, 332 U.S. 507 (1947) 31

*PPL EnergyPlus, LLC v. Nazarian*, 753 F.3d 467 (4th Cir. 2014), petition for cert. pending, No. 14-614 (filed Nov. 25, 2014) 30

*PPL EnergyPlus, LLC v. Solomon*, 766 F.3d 241 (3d Cir. 2014), petition for cert. pending, No. 14-694 (filed Dec. 10, 2014) 30

*Pub. Utils. Comm'n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927) 30

*Pub. Util. Comm'n of State of Cal. v. FERC*, 900 F.2d 269 (D.C. Cir. 1990) 4, 5

*Southern Cal. Edison Co. v. FERC*, 195 F.3d 17 (D.C. Cir. 1999) 22

*South Carolina Pub. Serv. Auth. v. FERC*, 762 F.3d 41 (D.C. Cir. 2014) 19

**ADMINISTRATIVE DECISIONS**

*Demand Response Compensation in Organized Wholesale Energy Markets*, 134 FERC ¶ 61,187 (2011) (FERC Order No. 745), 2011 WL 890975 *passim*

*Demand Response Compensation in Organized Wholesale Energy Markets*, 137 FERC ¶ 61,215 (2011) (FERC Order No. 745-A), 2011 WL 6523756 11, 20, 21

*In The Matter of an Investigation into the Regulation of Curtailment Service Providers*, 102 Md. PSC 246 (2011), 2011 WL 4435576 18

*PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331 (2006), 2006 WL 3762158 12

*Re Baltimore Gas and Electric Co.*, 101 Md. PSC 401 (2010), 2010 WL 3938140 37, 38

*Re Potomac Electric Power Company*, 101 Md. PSC 448 (2010), 2010 WL 3981655 38

*Removing Obstacles to Increased Electric Generation and Natural Gas Supply in The Western United States*, 94 FERC ¶ 61,272 (2001), 2001 WL 1842418 35

*Wholesale Competition in Regions with Organized Electric Markets*, 125 FERC ¶ 61,071 (2008) (FERC Order No. 719), 2008 WL 4686146 5, 15

*Wholesale Competition in Regions with Organized Electric Markets*, 128 FERC ¶ 61,059 (2009) (FERC Order No. 719-A), 2009 WL 2115220 10, 11, 15, 17, 18

**STATUTES AND REGULATIONS**

Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 4, 23, 24

Federal Power Act

Section 201, 16 U.S.C. § 824 *passim*

Section 201(d), 16 U.S.C. § 824(d) 23, 26

Section 205, 16 U.S.C. § 824d *passim*

Section 206, 16 U.S.C. § 824e *passim*

18 C.F.R. § 35.28(b)(4) 16, 24

Maryland Code Annotated, Public Utilities Article, § 2-101(b) 1

Maryland Code Annotated, Public Utilities Article, § 2-112(a) 1

Maryland Code Annotated, Public Utilities Article, § 2-113 2

Maryland Code Annotated, Public Utilities Article, § 7-211(b)(2) 36

Maryland Code Annotated, Public Utilities Article, § 7-501 33

Maryland Code Annotated, Public Utilities Article, § 7-510 2

66 Pa. Cons. Stat. Ann. § 301(a) 2

66 Pa. Cons. Stat. Ann. § 501 2

66 Pa. Cons. Stat. Ann. § 1301 2

66 Pa. Cons. Stat. Ann. § 1501 2

66 Pa. Cons. Stat. Ann. § 2801 33

66 Pa. Cons. Stat. Ann. § 2806.1(d) 37

66 Pa. Cons. Stat. § 2807(g) 37

## INTRODUCTION

Pursuant to Rule 25.1 of the Supreme Court Rules, Respondents, the Maryland Public Service Commission (Maryland PSC) and the Pennsylvania Public Utility Commission (Pennsylvania PUC) (collectively, "Joint States") respectfully submit this brief on the merits in support of Petitioners Federal Energy Regulatory Commission (FERC) and EnerNOC, Inc. et al. in Docket Nos. 14-840 and 14-841, which have been consolidated. The Maryland PSC and Pennsylvania PUC were respondents at the Court of Appeals.

In accord with Rule 24.2 of the Supreme Court Rules, Joint States, as respondents in support of Petitioners, have not included all of the elements of a brief on the merits otherwise required in subdivisions 1(b), (d), (e), (f) and (g).

The Maryland PSC is an independent unit in the executive branch of Maryland's government.[1] It regulates public service companies that engage in or operate utility businesses in the State, including Maryland's four investor-owned electric utilities, Baltimore Gas & Electric Company, Potomac Electric Power Company, Delmarva Power & Light Company, and Potomac Edison Company.[2] In its role as a regulator, the Maryland PSC is charged with promoting adequate, economical, and efficient delivery of utility services to the State's retail electric customers and enforcing compliance with the requirements of law,

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[1] Maryland Code, Public Utilities Article (PUA) § 2-101(b).

[2] *Id.* at § 2-112(a).

including requirements related to financial condition, capitalization, plant, operation, retail rates, and service.[3] Additionally, the Maryland PSC is charged with ensuring that distribution service is provided to customers at just and reasonable rates[4] and that the State meet long-term, anticipated demand for electric service.[5]

The Pennsylvania PUC is an independent administrative commission.[6] It has general administrative power and authority to supervise and regulate all public utilities doing business within the Commonwealth of Pennsylvania, including eleven public electric utilities.[7] In this role, the Pennsylvania PUC is charged with ensuring that every public utility furnishes and maintains adequate, efficient, safe, and reasonable service for the accommodation, convenience, and safety of its patrons, employees and the public.[8] The Pennsylvania PUC is also charged with ensuring that public utilities provide services at just and reasonable rates.[9] In executing its responsibilities, the Pennsylvania PUC balances the needs of consumers

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[3] *Id.* at § 2-113.

[4] *Id.* at § 7-510.

[5] *Id.* at § 7-510(c)(6).

[6] 66 Pa. Cons. Stat. Ann. § 301(a).

[7] 66 Pa. Cons. Stat. Ann. § 501.

[8] 66 Pa. Cons. Stat. Ann. § 1501.

[9] 66 Pa. Cons. Stat. Ann. § 1301.

and utilities; ensures safe and reliable utility service at reasonable rates; protects the public interest; educates consumers to make independent and informed utility choices; furthers economic development; and fosters new technologies and competitive markets in an environmentally sound manner.

## STATEMENT OF THE CASE

Pursuant to Rule 24.2, the Joint States adopt the Statement of the Case provided by Petitioners FERC and EnerNOC in their respective Briefs on the Merits.

## SUMMARY OF ARGUMENT

In determining that FERC illegally infringed upon the states' retail jurisdiction by regulating how demand response is compensated in wholesale markets, a majority panel of the D.C. Circuit Court (the "Majority") profoundly misconstrued the nature of demand response, which lies at the confluence of state and federal jurisdiction. *Elec. Power Supply Ass'n v. FERC*, 753 F.3d 216 (D.C. Cir. 2014). Demand response represents a resource that is vital to both retail and wholesale energy markets and it cannot be effectively regulated by either the states or FERC alone.[10] FERC understood that basic premise, which is why it has always made the participation of demand response in wholesale markets contingent on state acquiescence. In that regard, FERC's Rule addresses

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[10] In its Petition, the Solicitor General accurately referred to demand response as a "hybrid practice" that involves the decisions by end-use customers to curtail load as well as the payment by FERC-jurisdictional RTOs and ISOs for wholesale products. FERC Pet. at 28.

only payments made by wholesale power purchasers for demand-response resources used by wholesale-market operators to set the wholesale price. FERC did not change a single retail rate.

For over a decade and consistent with the direction of Congress,[11] FERC has taken action to remove barriers to participation of demand response in wholesale markets. In order to further that goal, in this rulemaking, FERC required that demand response resources be compensated consistent with comparable generation resources when it displaces a higher cost generation resource and is cost-effective. Nevertheless, FERC carefully worded its Rule to avoid infringing on historic state authority over the retail market.

The Joint States do not believe that FERC invaded their historic retail jurisdiction by providing rules upon which demand response may participate in wholesale markets. To the contrary, FERC appropriately regulated in an area of shared jurisdiction, involving the decision of end-use customers to curtail electric consumption, on one end, as well as the rules for participation and compensation in FERC jurisdictional wholesale markets for a resource that is comparable to generation, on the other. (*See* FERC Order 745, acknowledging that "demand response is a complex matter that lies at the confluence of state and federal jurisdiction;"[12] and *Pub. Util. Comm'n of State of Cal.*

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[11] Pub. L. No. 109-58, § 1252(f), 119 Stat. 594, 966 (2005).

[12] *Demand Response Compensation in Organized Wholesale Energy Markets*, 134 FERC ¶ 61,187 at ¶ 114 (2011) (Order No. 745), 2011 WL 890975 at * 30.

*v. FERC*, 900 F.2d 269, 274-275 (D.C. Cir. 1990), observing that the Federal Power Act (FPA) creates "interlocking jurisdiction between the states and FERC.")

The Majority correctly found that FPA § 201[13] limits the "practices affecting" jurisdiction of FERC by cabining off from federal regulation historic state authority over retail sales and generation, among other matters. However, contrary to the Majority's opinion, FERC's Rule does not directly regulate retail sales. The Rule applies only to what FERC has defined as wholesale demand response, which includes those demand response resources that participate directly in FERC's organized wholesale markets. Additionally, FERC's Rule carefully avoids direct regulation of retail energy markets by providing that any state may require the demand response resources within its boundaries to opt out. The Rule requires that Regional Transmission Organizations (RTOs) and Independent System Operators (ISOs) accept wholesale bids from demand response resources "unless the laws or regulations of the relevant electric retail regulatory authority do not permit a retail customer to participate."[14] FERC also preserved the states' retail jurisdiction by leaving to state discretion other significant issues pertaining to participation, such as whether demand response aggregators may do business under state or local laws and whether and how they

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[13] 16 U.S.C. § 824.

[14] *Wholesale Competition in Regions with Organized Electric Markets*, 125 FERC ¶ 61,071 (2008) (Order No. 719) at ¶155, 2008 WL 4686146 at * 35.

may contract with electricity end-users. To the extent FERC's Rule affects retail sales, it is merely incidental and not prohibited by the FPA.

The Majority's conclusion that FERC's Rule contains no limiting principle is also erroneous. The Rule clearly limits payment to demand response resources to those resources that participate directly in FERC's wholesale markets and that have a direct and substantial effect on wholesale rates, which the resource demonstrates through FERC's Net Benefit Test. Additionally, courts addressing the scope of FERC's jurisdiction under the FPA have had no difficulty in distinguishing between direct and attenuated effects on retail sales. *See, e.g., Cal. Indep. Sys. Oper. Corp. v. FERC*, 372 F.3d 395, 403 (D.C. Cir. 2004).

Unfortunately, the Majority invalidated FERC's Rule by erroneously holding that FERC lacks jurisdiction over demand response, finding that it is essentially a retail product.[15] Having found the language of the FPA unambiguous as it relates to demand response, the Majority mistakenly determined that it was not required to apply step two of the Court's traditional *Chevron* analysis, thereby failing to give any weight to FERC's decade-long experience with the resource and substantial familiarity with its enabling statute. The Majority's determination is wrong. The FPA is silent regarding demand response. Congress did not define demand response as a retail or a wholesale product, thereby leaving ambiguous how Congress intended the resource to be addressed. As the

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[15] Pet. App. 8a n.1.

FPA is ambiguous as to wholesale demand response, step two of *Chevron* analysis should have been applied. Under that analysis, the Majority should have given deference to FERC's reasonable interpretation of wholesale demand response as a practice that affects wholesale prices.

The Majority's decision to remove demand response from wholesale markets will impose profound negative impacts on customers. First, it is deleterious to wholesale and retail markets because it creates a regulatory gap, whereby neither FERC (because of the *EPSA* decision itself) nor the states (because of the states' lack of jurisdiction over wholesale rates) can effectively regulate a resource vital to the health of energy markets. Second, restructured states rely on wholesale demand response to provide meaningful price signals to end-users and to provide mitigation of market power in wholesale markets. Third, the states rely on demand response to meet important environmental and policy goals, including mandates to reduce energy consumption and to decrease reliance on carbon-emitting generation resources. Perhaps most regrettably, the Majority's decision precludes state commissions from working cooperatively with FERC to allow retail customers to bid their demand response capabilities into wholesale markets, causing damage to both wholesale and retail markets.

Finally, FERC appropriately set compensation for demand response at full locational marginal price (LMP). FERC carefully examined the barriers to entry of demand response and found that comparable treatment to generation was required in order to achieve the just and reasonable level of participation of

the resource in wholesale markets as well as just and reasonable wholesale energy prices. Contrary to the Majority's opinion, FERC specifically addressed and appropriately rejected the arguments against this level of compensation.

## ARGUMENT

### I. FERC'S RULE PROPERLY EXERTS JURISDICTION OVER WHOLESALE DEMAND RESPONSE

#### A. FERC Possesses Authority Under FPA Sections 205 and 206 to Regulate Wholesale Demand Response as a Practice Affecting Wholesale Rates

FERC has authority pursuant to FPA sections 205 and 206 to regulate wholesale demand response as a practice affecting wholesale rates, as long as FERC does not directly regulate a matter under state control, such as retail sales or generation.[16] The wholesale demand response that is the subject of FERC's Rule confers profound benefits on wholesale rates and falls easily within the "affecting" language of the FPA. Because FERC has carefully worded its Rule to avoid intrusion into historic state authority over retail decisions, including decisions relating to end-use demand responders and aggregators, FERC is not precluded under FPA section 201 from regulating wholesale demand response.

In its Rule on demand response, FERC exercised jurisdiction pursuant to the "affecting" language of

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[16] 16 U.S.C. § 824d and 16 U.S.C. § 824e, respectively.

sections 205 and 206.[17] FPA sections 205 and 206 generally impose upon FERC the responsibility to ensure that rates and charges for transmission and wholesale power sales by public utilities[18] are just and reasonable and not unduly discriminatory or preferential. The two FPA sections grant FERC slightly different powers. Section 205 requires FERC to ensure that all public utility rates and charges are just and reasonable and that "all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable..." Any rate that does not meet that requirement is unlawful. FPA section 206 authorizes FERC on its own motion or upon complaint to determine that any rate, charge, or classification relating to a public utility, or "any rule, regulation, practice, or contract affecting such rate, charge or classification," is "unjust, unreasonable, unduly discriminatory or preferential" and to "determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force..." Courts have consistently held that FERC's jurisdiction under its "affecting" authority

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[17] One significant difference between Sections 205 and 206 is the required burden of proof. Section 205 requires that the proponent (usually the public utility whose tariff is on file) demonstrate that the new proposed rate, term or condition is just and reasonable. In contrast, section 206 requires that the proponent demonstrate not only that the proposed change is just and reasonable, but also that the existing provisions are unjust and unreasonable.

[18] The FPA defines "public utility" as "any person who owns or operates facilities subject to the jurisdiction of the Commission under this subchapter." FPA § 201(e), 16 U.S. Code § 824(e).

is broad. *City of Cleveland v. FERC*, 773 F.2d 1368, 1376 (D.C. Cir. 1985).

FERC correctly determined that wholesale demand response is a rule, regulation, or practice affecting wholesale rates.[19] Indeed, the record in this case is replete with examples of the many salutary benefits demand response confers upon FERC-jurisdictional rates and wholesale markets. First, demand response lowers wholesale prices by reducing a load-serving entity's need to purchase power from the wholesale market and by flattening an area's load profile.[20] For example, demand response reduces the need during peak demand periods to call on highly expensive generator peaking units. Second, demand response reduces price volatility through its disciplining effect on wholesale market prices. Third, demand response mitigates the market power of suppliers of electricity in uncompetitive markets because they have to compete with demand response resources and adjust their bidding strategy accordingly.[21] Specifically, demand response places downward pressure on generator bidding strategies "by increasing the risk to a supplier that it will not be dispatched if it bids a price that is too high."[22] Fourth, demand response reduces transmission rates by relieving congestion on

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[19] *See* FERC Order 745 at ¶¶ 112-113, 2011 WL 890975 at * 30.

[20] *Wholesale Competition in Regions with Organized Electric Markets*, 128 FERC ¶ 61,059 (2009) (FERC Order No. 719-A) at ¶ 47, 2009 WL 2115220 at * 12.

[21] *Id.*

[22] *Id.*

transmission lines that otherwise leads to higher transmission charges.[23] Finally, demand response enhances system reliability, by reducing demand at critical times, such as when generating units or transmission lines unexpectedly fail.[24] All of these demonstrated benefits support FERC's conclusion that wholesale demand response constitutes a rule, regulation, or practice affecting wholesale rates.

Indeed, FERC correctly determined not only that demand response affects wholesale rates, but that wholesale prices in FERC-jurisdictional markets would not be just and reasonable without demand response. In Order No. 719-A, for example, FERC concluded that "reducing barriers to demand response in the organized wholesale markets helps the Commission to fulfill its responsibility ... for ensuring that those rates are just and reasonable."[25] With regard to the PJM RTO in particular, FERC decided that "the current lack of meaningful demand side response is a flaw in the

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[23] *Demand Response Compensation in Organized Wholesale Energy Markets*, 137 FERC ¶ 61,215 (2011) at ¶ 23 n. 51, (Order No. 745-A), 2011 WL 6523756 at *6 n. 51.

[24] Dissenting FERC Commissioner Moeller (who dissented only regarding the compensation for demand response, not FERC's jurisdiction over the resource), aptly articulated the many benefits of demand response, stating "[N]owhere did I review any comment or hear any testimony that questioned the benefits of having demand response resources participate in the organized wholesale energy markets. On this point, there is no debate." Order No. 745, Commissioner Moeller Dissenting Opinion at 1, 2011 WL 890975 at * 34.

[25] FERC Order No. 719-A at ¶ 47, 2009 WL 2115220 at * 12.

markets operated by PJM which, if not corrected, could lead to dysfunction in those markets."[26] *See* also *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331 at ¶ 1 (2006), 2006 WL 3762158 at * 1, (In order to ensure just and reasonable rates, the Commission "must approve market designs and rate policies that elicit sufficient investment in energy, transmission, and demand response.")

### B. FERC's Rule Does Not Directly Regulate Retail Sales

The D.C. Circuit appears to have conceded that "demand response compensation affects the wholesale market." Pet. App. 7a. However, the court held that the broad "affecting" language of sections 205 and 206 "does not erase the specific limits of section 201." Pet. App. 8a. FPA section 201(b)(1) curbs FERC's general authority over wholesale rates and practices affecting such rates by cabining off the historic jurisdiction of states. For example, that section provides that FERC's jurisdiction "shall not apply to any other sale of electric energy" or to "facilities used for the generation of electric energy or over facilities used in local distribution ..." The D.C. Circuit determined that although demand response directly affects wholesale rates, FERC does not possess jurisdiction over demand response resources because such jurisdiction would constitute direct regulation of retail rates, a matter exclusively reserved to the states under the FPA. Specifically, the court stated "Congress intended

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[26] *PJM Interconnection, L.L.C.*, 95 FERC ¶ 61,306, at p. 62,043 (2001), 2001 WL 34076815 *4.

demand response resources to be regulated by states, as part of the retail market." Pet. App. 11a.

The Joint States agree with the Majority Opinion that FERC may not directly regulate those areas of the FPA that are carved out as exclusively state jurisdictional, including retail rates and generation.[27] *See Niagara Mohawk Power Corp. v. FERC*, 452 F.3d 822, 824 (D.C. Cir. 2006). However, we disagree with the conclusion that by regulating wholesale demand response as FERC has defined it, FERC is directly regulating retail rates. *Conn. Dept. of Public Utility Control v. FERC*, 569 F.3d 477 (D.C. Cir. 2009) provides a recent and analogous example of FERC exercising jurisdiction through the "affecting" language

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[27] Indeed, the Joint States are very concerned with preserving jurisdiction over historic areas of state authority, including retail sales and generation, and are in agreement with the strong limiting principles articulated in *Conn. Light & Power Co. v. Federal Power Comm.*, 324 U.S. 515, 526 (1945), where this Court explained:

> The [FPA] takes no authority from State commissions and contains provisions authorizing the Federal Commission to aid the State commissions in their efforts to ascertain and fix reasonable charges. The new parts are so drawn as to be *a complement to and in no sense a usurpation of State regulatory authority* and contain throughout directions to the Federal Power Commission *to receive and consider the views of State commissions*. Probably, no bill in recent years has so recognized the responsibilities of State regulatory commissions as does [the FPA].

(Emphasis added). The Joint States conclude, however, that FERC did not overstep its jurisdictional boundaries by regulating wholesale demand response.

of the FPA without violating the restrictions of FPA section 201. In that case, FERC reviewed ISO New England's Installed Capacity Requirement (ICR), which represents the estimated amount of capacity required for reliability three years in the future, and is a critical input into the capacity auction between New England's load serving entities and generators. The petitioners challenged FERC's authority to review the ICR, claiming that the review constituted direct regulation of electric generation facilities, because the setting of the ICR would mandate the amount of capacity states must acquire and ultimately compel the construction of new generation through higher prices. The court agreed that FERC was prohibited under FPA section 201 from directly regulating generation, but held that review of the ICR did not constitute such direct regulation.[28] Instead, the court found that Connecticut retained the right to approve or deny applications to build new power projects. "Determination of the ICR affects rates within the Commission's jurisdiction and, in evaluating whether that determination is just and reasonable, the Commission neither regulates generation facilities in violation of section 201 nor runs afoul of any other provision of the Federal Power Act."[29] In denying the petition, the court emphasized the autonomy left to the states in ISO New England over generation facilities, stating: "State and municipal authorities retain the right to forbid new entrants from providing new capacity, to require retirement of existing generators, to limit new construction to more

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[28] *Id.* at 482.

[29] *Id.* at 485.

expensive, environmentally-friendly units, or to take any other action in their role as regulators of generation facilities without direct interference from the Commission."[30]

Similarly, in the present case, FERC has narrowly crafted its Rule over demand response to avoid directly regulating the retail energy markets.[31] For example, FERC respected the states' historic jurisdiction over retail procurement and rates by providing that any state may require the demand response resources within its boundaries to opt out. The agency required RTOs and ISOs to accept wholesale bids from demand response resources "unless the laws or regulations of the relevant electric retail regulatory authority do not permit a retail customer to participate."[32] FERC clarified that "we will not require a retail regulatory authority to make any showing or take any action in compliance with this rule."[33] Indeed, Order No. 745 does not change a single retail rate nor does it compel

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[30] *Id.* at 481.

[31] *See* Order No. 719-A at ¶ 48, 2009 WL 2115220 at * 12, noting that FERC had created a "very narrowly-focused rule" with respect to demand response resources that was designed to effectuate Congress' directive to reduce certain barriers to demand response participation in wholesale markets.

[32] Order No. 719 at ¶ 155, 2008 WL 4686146 at * 35. *See* also *id.* at ¶ 114, 2008 WL 4686146 at * 25, "the Commission is not requiring actions that would violate state laws or regulations. The Commission also is not regulating retail rates or usurping or impeding state regulatory efforts concerning demand response."

[33] *Id.* at ¶ 53.

a single retail term or condition of service. FERC merely required that its jurisdictional entities, the RTOs and ISOs, accept voluntary bids from demand response resources under certain circumstances, leaving states with the ultimate authority over the eligibility of such resources within their territories.

Another manner in which FERC properly limited the effect of its Rule to avoid impinging upon areas of historic state control was in restricting FERC-jurisdictional demand response under the Rule to *wholesale* demand response. In its regulation, FERC defined demand response generally as "reduction in the consumption of electric energy by customers from their expected consumption in response to an increase in the price of electric energy or to incentive payments designed to induce lower consumption of electric energy."[34] FERC acknowledged that "price-responsive demand," whereby customers reduce demand by responding to rates that are based on wholesale prices, is a "retail-level" demand response, which is outside the scope of its regulatory authority.[35] The agency further clarified that "[w]hile a number of states and utilities are pursuing retail-level price-responsive demand initiatives based on dynamic and time differentiated retail prices and utility investments in demand response enabling technologies, these are state efforts, and, thus, are not the subject of this

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[34] Order 745 at ¶ 2 n. 2, 2011 WL 890975 at * 1, citing 18 C.F.R. § 35.28(b)(4).

[35] *Id.* at ¶¶ 1-3 and n. 2. 2011 WL 890975 at * 1. FERC's Rule ensures that "States remain free to authorize and oversee retail demand response programs." *Id.* at 14-15.

proceeding." In contrast, a reduction in the consumption of energy in response to RTO/ISO incentive payments represents "wholesale demand response" and is the focus of FERC's Rule.[36] FERC clarified that wholesale demand response occurs when customers provide demand response that acts as a resource in organized wholesale energy markets to balance supply and demand. Importantly, the RTO/ISO tariff provisions that govern how wholesale demand response may participate in wholesale energy, capacity, and ancillary services markets are not now nor have ever been a part of the states' historic jurisdiction over retail rates. Indeed, the states could not satisfactorily duplicate FERC-jurisdictional demand response provisions in wholesale markets to make demand response operate as effectively as it currently does.

FERC also preserved the states' retail jurisdiction by leaving to state discretion not just whether to allow participation of demand response resources situated within the states in FERC's wholesale markets, but other significant issues pertaining to participation. For example, FERC stated that the "Rule also does not make findings about retail customers' eligibility, under state or local laws, to bid demand response into the organized markets, either independently or through an ARC."[37] FERC further clarified that it "does not intend

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[36] Order 745 at ¶¶ 1-3, n. 2, 2011 WL 890975 at * 1.

[37] Order 719-A at ¶ 54, 2009 WL 2115220 at * 14. The acronym ARC stands for an Aggregator of Retail Customers, which is a third-party person who assembles end-use customers who are willing to curtail load and then bids their aggregated demand

to make findings as to whether ARCs may do business under state or local laws, or whether ARCs' contracts with their retail customers are subject to state and local law. ... [W]e leave it to the appropriate state or local authorities to set and enforce their own requirements."[38] Given FERC's limited Rule addressing wholesale demand response only, as well as the limitations FERC places on the Rule to protect state discretion, it is clear the Rule did not intrude upon state jurisdiction by directly regulating retail rates. Instead, the Rule addresses only payments made by wholesale power purchasers for demand-response resources used by wholesale-market operators to set the wholesale price. The effect of FERC's Rule on retail markets, if any, is merely incidental. *See Nat'l Ass'n of Regulatory Util. Comm'rs v. FERC*, 475 F.3d 1277, 1280 (D.C. Cir. 2007) (observing that FERC's authority to act within the statutory scope of its jurisdiction "may, of course, impinge as a practical matter on the behavior of non-jurisdictional" entities).

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response offers into wholesale markets.

[38] *Id.* Some states have developed consumer protection and/or reliability-related criteria with which aggregators of demand response that bid into RTOs and ISOs on behalf of smaller retail customers need to comply. *See*, e.g., Maryland PSC Order No. 84275, *In The Matter of an Investigation into the Regulation of Curtailment Service Providers*, 102 Md.P.S.C. 246 (2011), 2011 WL 4435576, which provides an example of appropriate interlocking state and federal jurisdictional efforts.

### C. The Majority's "No Limiting Principle" Argument Is Misguided

The court below expressed concern that FERC's jurisdiction over demand response as a matter directly affecting wholesale energy rates "has no limiting principle" and would allow FERC "to regulate any number of areas, including the steel, fuel and labor markets." Pet. App. 7a. The panel's "no limiting principle" argument is misguided because demand response *directly* affects wholesale prices and clearly constitutes an energy resource; unlike the steel, fuel, and labor, which the panel cites as examples of indirect factors that may affect wholesale electric prices. Those latter resources do not bid into FERC's wholesale markets and at most create an attenuated effect on bidding. Courts addressing the scope of FERC's jurisdiction under the FPA and the Natural Gas Act (NGA) have had no difficulty in distinguishing between direct effects and attenuated effects. *See, e.g., Cal. Indep. Sys. Oper. Corp. v. FERC*, 372 F.3d 395, 403 (D.C. Cir. 2004) ("[S]ection 206's empowering of the Commission to assess the justness and reasonableness of practices affecting rates of electric utilities is limited to those methods or ways of doing things on the part of the utility that directly affect the rate or are closely related to the rate, not all those remote things beyond the rate structure that might in some sense indirectly or ultimately do so."); and *South Carolina Public Service Authority v. FERC*, 762 F.3d 41, 74-76 (D.C. Cir. 2014).

Despite the accusations of the Majority to the contrary, in its underlying order, FERC articulated a limiting principle, stating that FERC would not exert

jurisdiction simply because an input to generation may affect a wholesale rate, but rather, would regulate demand response because it is a direct participant in FERC's wholesale markets and has a direct and substantial effect on rates in those markets.[39] Additionally, FERC's Rule provides for demand response compensation only when an RTO or ISO can use the demand response resource in lieu of generation to balance supply and demand and when paying a demand response resource is cost-effective (FERC's Net Benefit Test). In other words, the Rule's compensation requirement applies only when a demand response resource would alter the wholesale price of energy, which is by definition a direct effect. The Joint States therefore do not view the theoretical lack of a limiting principle that is not present given the facts at hand as a valid reason for scuttling the wholesale markets for demand response resources.[40]

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[39] FERC stated: "We recognize that merely because an input to generation may affect a wholesale rate, our jurisdiction does not extend to the regulation of the input itself. Demand response resources that participate in an RTO- or ISO-administrated organized wholesale energy market, however, are not merely an input cost for generation that indirectly affects wholesale rates. Rather, in the circumstances covered by the Final Rule, demand response resources are direct participants in the organized wholesale energy markets over which we have jurisdiction (just as is generation), and that participation has a direct and substantial effect on rates in those markets." FERC therefore correctly dismissed the charge that "the Final Rule create[s] a slippery slope that will lead to limitless Commission jurisdiction." Order No. 745-A at ¶ 31, 2011 WL 6523756, at *9.

[40] Despite the Joint States' strong support of FERC jurisdiction in this case, we agree with the principle stated by the California

## II. *CHEVRON* ANALYSIS SUPPORTS FERC'S CONCLUSION THAT IT POSSESSES JURISDICTION PURSUANT TO THE FPA OVER WHOLESALE DEMAND RESPONSE

### A. Demand Response Does Not Unambiguously Constitute a Retail Product Under the FPA

The Majority should have concluded that FERC possesses jurisdiction over demand response resources pursuant to the "affecting" language of FPA sections 205 and 206, as described in Section I above. Instead, the court erroneously found that demand response unambiguously constitutes a retail product under the FPA, stating "we...find that demand response, while not necessarily a retail sale, is indeed part of the retail market, which, as the statute and case law confirm, is exclusively within the state's jurisdiction." Pet. App. 8a n. 1. Because the Majority found the retail nature of demand response under the FPA to be unambiguous, it determined that it was not required to analyze

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Public Utilities Commission that FERC's jurisdiction pursuant to FPA sections 205 and 206 over practices affecting wholesale rates cannot be read to be limitless, especially with regard to matters of historic state jurisdiction. One appropriate limiting principle is that the subject of FERC regulation must be "direct participants in the organized wholesale energy markets...." FERC Order 745-A at ¶ 31, 2011 WL 6523756, at *9. *See City of Cleveland*, 773 F.2d at 1376 ("The statutory directive must reasonably be read to require the recitation of only those practices that affect rates and service significantly....") This principle prevents FERC from meandering into areas outside its clear purview. In this case, however, because wholesale demand response does directly participate in FERC's wholesale markets, FERC has properly exercised jurisdiction.

FERC's interpretation of its statutory authority under step two of *Chevron*. The Majority reasoned: "Because the Federal Power Act unambiguously restricts FERC from regulating the retail market, we need not reach *Chevron* step two." Pet. App. 13a. The Majority's conclusion was wrong. Demand response is not unambiguously a retail product only. Rather, it is a vital and complex resource that contains retail and wholesale characteristics and is best regulated through shared state and federal jurisdiction, which FERC has ably articulated in its Rule.

*Chevron* analysis is straightforward and familiar to the Court. Challenges to FERC's interpretation of the FPA are reviewed under the two-step framework of *Chevron U.S.A. Inc. v. NRDC, Inc.*, 467 U.S. 837, 842-43 (1984). Relying on the traditional tools of statutory construction, the Court first considers whether Congress addressed the precise question at issue. *See Southern Cal. Edison Co. v. FERC,* 195 F.3d 17, 22-23 (D.C. Cir. 1999). If the language of the statute is clear as relates to the issue being examined, then that is the end of the matter. If, however, "the statute is silent or ambiguous with respect to the specific issue," then the Court must determine "whether the agency's answer is based on a permissible construction of the statute."[41]

In this case, the *Chevron* analysis must start with the language of the FPA. FPA section 201(b)(1) establishes FERC jurisdiction over the transmission of

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[41] *Chevron*, 467 U.S. at 843. Deference to an agency's reasonable construction of a statute is appropriate to both the application and scope of the agency's authority. *City of Arlington v. FCC*, 133 S.Ct. 1863, 1868 (2013).

electric energy in interstate commerce and the sale of electric energy at wholesale in interstate commerce.[42] FPA section 201(d) defines "sale of electric energy at wholesale" as "a sale of electric energy to any person for resale." FPA section 201(b)(1) also contains limitations on FERC's authority, restricting from FERC's jurisdiction the states' traditional authority over matters such as retail rates and generation. Specifically, the language provides that FERC jurisdiction "shall not apply to any other sale of electric energy" or "over facilities used for the generation of electric energy or over facilities used in local distribution...." The other sections of the FPA relevant to this case are FPA sections 205 and 206, which provide broad federal authority over rules, regulations, and practices "affecting" FERC jurisdictional wholesale rates. Nevertheless, FERC's "affecting" authority is limited by the constraints described in FPA section 201(b).

The FPA is silent as to demand response and demand response resources.[43] Congress did not

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[42] 16 U.S.C. § 824(b)(1).

[43] While the FPA is silent regarding demand response, the Energy Policy Act of 2005 explicitly directs FERC to eliminate barriers to entry of demand response, providing as follows:

> It is the policy of the United States that time-based pricing and other forms of demand response, where by electricity customers are provided with electricity price signals and the ability to benefit by responding to them, shall be encouraged, the deployment of such technology and devices that enable electricity customers to participate in such pricing and demand response systems shall be facilitated, and unnecessary barriers to demand response

explicitly address whether FERC has jurisdiction over demand response resources and thus did not directly speak to whether FERC may establish rules governing payments for reductions in electricity consumption and the recouping of those payments through adjustments to wholesale rates. FERC's Rule does define demand response, not as a sale, but as a "reduction in the consumption of electric energy by customers from their expected consumption in response to an increase in the price of electric energy or to incentive payments designed to induce lower consumption of electric energy."[44] Applying FERC's Rule to the FPA, demand response is neither the transmission of electric energy,

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> participation in energy, capacity and ancillary service markets shall be eliminated. It is further the policy of the United States that the benefits of such demand response that accrue to those not deploying such technology and devices, but who are part of the same regional electricity entity, shall be recognized.

Pub. L. No. 109-58, § 1252(f), 119 Stat. 594, 966 (2005). This language strongly indicates Congress' intent that the deployment of regional (RTO/ISO) demand response should be encouraged and that unnecessary barriers to demand response participation in regional (RTO/ISO) wholesale energy, capacity and ancillary service markets are to be eliminated. Furthermore, although the Majority argued that Congress' policy statement should be read to support state jurisdiction over demand response only (Pet. App. 11a), the Joint States observe that Congress spoke specifically to "energy, capacity and ancillary service markets," which are, of course, the RTO/ISO wholesale markets subject to FERC's jurisdiction.

[44] Order 745 at ¶ 2 n. 2, 2011 WL 890975 at * 1, citing 18 C.F.R. § 35.28(b)(4).

nor the sale of electric energy.[45] The Majority agrees, stating "demand response is not a wholesale sale of electricity; in fact, it is not a sale at all." Pet. App. 6a. It is unclear, therefore, how the Majority reached its apparent conclusion that FERC is precluded from regulating demand response because it constitutes "any other sale of electric energy" under FPA 201(b). At most, whether demand response is a "sale" under the FPA is ambiguous.

Dissenting Judge Edwards provides a compelling analysis regarding why the FPA is ambiguous about which side of the jurisdictional line demand response falls. He noted that the FPA does not clearly address whether forgone consumption constitutes a "sale," nor does the FPA provide that demand response must be treated solely as a matter of retail regulation.[46] Instead, Judge Edwards astutely observed that the nature of demand response as either retail or wholesale depends on how one starts the analysis. He remarked "it is easy to conceive of Order 745 as permissibly falling on the wholesale side of the wholesale-retail jurisdictional line. On another view, however, the electricity not consumed thanks to the rule's compensation payment would have been consumed first in the retail market. Focusing on the market in which the consumption would have occurred in the first instance, one can conceive of Order 745 as

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[45] *See also* Order 745 at ¶ 64, 2011 WL 890975 at *18 ("[T]he Commission does not view demand response as a resale of energy back into the energy market.").

[46] Pet. App. 16a, *Electric Power Supply Ass'n. v. FERC*, 753 F.3d. 216, 236 (D.C. Cir. 2014).

impermissibly falling on the retail side of the jurisdictional line."[47] What the Majority should have focused on instead of that circular line of thinking, according to Judge Edwards, was whether the FPA "unambiguously speaks to the precise question."[48] He concluded, correctly, that it did not.

In assessing the language of the FPA against the "precise question at issue," – namely, whether demand response unambiguously constitutes solely a retail practice – it is important to consider the enormous changes that have occurred in the power industry since passage of the FPA in 1935. When the FPA was written, including sections 201, 205 and 206, most electricity was sold by vertically integrated utilities that built their own power plants, transmission lines, and local delivery systems for ratepayers living in

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[47] Pet. App. 18a. Judge Edwards raises important questions about the nature of demand response. The resource is not innately wholesale energy – a household cannot run appliances off of demand response alone. However, in the aggregate, demand response provides wholesale benefits that are often equivalent to generation. As discussed in Section I above, it can help balance supply and demand during peak-load periods, act as a generation substitute during system emergencies, put competitive pressures on generator bids, relieve transmission congestion constraints, and enhance system reliability. Additionally demand response is often sold into wholesale markets through third party aggregators (called curtailment service providers in state retail markets), who aggregate individual end-use demand responders, whether commercial, industrial, or residential, and then sell the aggregated product into FERC's markets. As articulated by the FPA, "a sale of electric energy to any person for resale" is the definition of a wholesale transaction. FPA § 201(d).

[48] *Chevron*, 467 U.S. at 842.

defined service territories.[49] Utilities operated as local monopolies that sold a "bundled" electric product to ratepayers, meaning that consumers paid a single charge that included the costs of generation, transmission and distribution. Over the last few decades, technological and regulatory developments have radically altered the formerly staid electric industry, with FERC requiring open access to wholesale transmission lines and enabling the significant penetration of merchant generation, and states like Maryland and Pennsylvania restructuring their retail electric industries and unbundling retail markets. The traditional vertically-integrated monopoly was replaced in many states with RTOs and ISOs, which coordinate the movement of wholesale electricity between generators and transmission operators across multiple states and run complex wholesale energy, capacity and ancillary services markets under FERC's oversite. *See New York v. FERC*, 535 U.S. 1, 16 (2002) ("[T]he landscape of the electric industry has changed since the enactment of the [Federal Power Act], when the electricity universe was neatly divided into spheres of retail versus wholesale sales." (Internal quotations omitted). Into that new and dramatically different energy model emerged wholesale demand response – a valuable resource that can rapidly balance the demand and supply of electricity at critical times. But it is not a resource that fits neatly into the 1935 FPA. In any event, given the significant changes in the energy industry, and the emergence of the new resource of demand response, it is unlikely that Congress enacted

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[49] *New York v. FERC*, 535 U.S. 1, 5 (2002).

language directed at the precise issue at hand. *See Automated Power Exchange, Inc. v. FERC*, 204 F.3d 1144, 1151 (D.C. Cir. 2000).

Since Congress did not speak to the precise issue involved in this case, and demand response is not unambiguously retail in nature, the Majority should have reached *Chevron* step two. Under *Chevron* step two, "the question for the Court is whether the agency's answer is based on a permissible construction of the statute." *Chevron*, 467 U.S. at 843. As set forth in detail in Section I hereof, FERC's answer to the problem of how to regulate demand response in wholesale markets is based on a permissible construction of the FPA. An agency's rule should not be disturbed unless it is "arbitrary or capricious in substance, or manifestly contrary to the statute." *Mayo Foundation for Medical Educ. and Research v. U.S.*, 562 U.S. 44, 53 (2010). This is true even with respect to an agency's jurisdictional interpretations. *See, City of Arlington v. FCC,* 133 S.Ct. 1863 (2013) ("Where Congress has established a clear line, the agency cannot go beyond it; and where Congress has established an ambiguous line, the agency can go no further than the ambiguity will fairly allow. But in rigorously applying the latter rule, a court need not pause to puzzle over whether the interpretive question presented is 'jurisdictional.' If the agency's answer is based on a permissible construction of the statute, that is the end of the matter.")[50] (Internal citation omitted).

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[50] The Joint States further observe that FERC is uniquely qualified to understand the technical complexities associated with modern interconnected transmission grids, and thus deference to FERC's interpretation of its own jurisdiction over them is particularly

FERC's exercise of jurisdiction over wholesale demand response pursuant to the "affecting" language of sections 205 and 206 cannot be considered arbitrary or capricious. FERC, in accordance with its statutory directives, properly established a Rule for demand response in organized wholesale markets because demand response has a direct and substantial effect on rates in those markets; because FERC's Rule is narrowly crafted to avoid directly regulating the retail energy markets; because otherwise, as set forth below, there would be a regulatory void where neither FERC nor the states can effectively regulate; and because if neither FERC nor the states can effectively regulate demand response, the just and reasonable rate purposes of the FPA will be thwarted and demand response will not be fully utilized, to the detriment of all.

### B. The Majority's Decision Inappropriately Creates the Risk of a Regulatory Gap

The Majority's decision is additionally problematic because it creates an apparent regulatory gap between

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appropriate. *See City of Arlington v. FCC*, 133 S.Ct. 1863, 1868, (2013) ("Congress, when it left ambiguity in a statute' administered by an agency, 'understood that the ambiguity would be resolved, first and foremost, by the agency, and desired the agency (rather than the courts) to possess whatever degree of discretion the ambiguity allows;)" and *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132 (2000) ("[s]uch deference is justified because '[t]he responsibilities for assessing the wisdom of such policy choices and resolving the struggle between competing views of the public interest are not judicial ones,' and because of the agency's greater familiarity with the ever-changing facts and circumstances surrounding the subjects regulated.")

the federal and state regulation of demand response, leaving state and federal regulators bereft of the authority necessary to regulate the important resource. The gap exists because of (i) the Majority's decision that FERC cannot regulate demand response in wholesale markets and (ii) the states' lack of authority over wholesale markets. As the Solicitor General stated in its Petition: "Under settled FPA regulatory preemption principles, States could not regulate the wholesale-market rules addressed in the Rule, because such regulation would directly alter the terms of wholesale transactions."[51]

The creation of a regulatory gap is contrary to the intention of the FPA and undermines the Majority's decision that FERC lacks authority over demand response resources. The enactment of the FPA in 1935 closed the "*Attleboro* gap," created when the Supreme Court determined that states could not regulate electric energy in interstate commerce, a power that was vested only in Congress. *Public Util. Comm'n of R. I. v. Attleboro Steam & Elec. Co.*, 273 U.S. 83, 89 (1927).

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[51] Petition at 26. The Third and Fourth Circuits recently held that state commission determinations to increase generation (on the state side of the jurisdictional line) through long-term contracts tied to FERC's wholesale markets were preempted. If that reasoning were applied to demand response, the Majority's decision could leave the resource in a regulatory void where neither FERC nor the states can effectively regulate. *See PPL EnergyPlus, LLC v. Nazarian*, 753 F.3d 467 (4th Cir. 2014), petition for cert. pending, No. 14-614 (filed Nov. 25, 2014); *PPL EnergyPlus, LLC v. Solomon*, 766 F.3d 241 (3d Cir. 2014), petition for cert. pending, No. 14-694 (filed Dec. 10, 2014). The Maryland PSC has filed a Petition for *Certiorari* of the *Nazarian* case, which is pending before the Court.

Congress passed the FPA in response, creating the Federal Power Commission (the predecessor of FERC), "to provide effective federal regulation of the expanding business of transmitting and selling electric power in interstate commerce." *New York v. FERC*, 535 U.S. 1 (2002), quoting *Gulf States Util. Co. v. FPC*, 411 U.S. 747, 758 (1973). Courts have held that the FPA must be read broadly to effectuate Congress' intention to create a comprehensive and effective regulatory scheme. *Panhandle Eastern Pipe Line Co. v. Public Service Comm'n*, 332 U.S. 507, 520 (1947). Although Congress reserved much authority for the states, it is clear that Congress did not want "an important aspect of this field to be left unregulated." *Federal Power Comm'n v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 19 (1961). Thus, this Court has stated its inclination not to approach the problem negatively, and to avoid the "possibility that a no-man's land will be created." *Id.* "[I]n a borderline case where congressional authority is not explicit" this Court has posed the question as "whether state authority can practicably regulate a given area" and has stated, "if we find that it cannot, then we are impelled to decide that federal authority governs." *Id.* at 19-20.

Regarding demand response, a regional wholesale market is the platform that has been developed over many years to provide the most efficient mechanism for demand response to be dispatched to help balance supply and demand at a variety of locations across a large grid area. At most, the Majority's decision leaves only the possibility for a balkanized market to develop, where states are required to patch together individual rules for participation of demand response resources at the retail level, with no clear mechanism for monetarily

incentivizing such resources to participate. Such a patchwork approach would operate without the currently available short term information flow necessary to dispatch demand response consistently with grid needs and market benefits. The likelihood is that huge portions of demand response will simply disappear if the Majority's decision stands. Ultimately, the states will not be able to fill the void left by FERC in ensuring participation of demand response at the wholesale level.[52] Having enacted the FPA to close a regulatory gap, it is axiomatic that the statute should not be interpreted as introducing another such gap.

## III. REMOVAL OF DEMAND RESPONSE FROM WHOLESALE MARKETS WILL IMPOSE PROFOUND NEGATIVE IMPACTS ON CUSTOMERS

FERC exercised jurisdiction to regulate what its Rule defines as wholesale demand response pursuant to FPA sections 205 and 206. The primary purpose of the Federal Power Act, as articulated in section 205(a), is to protect consumers from excessive rates and charges. *Municipal Light Boards of Reading and Wakefield, Mass. v. Federal Power Comm'n*, 450 F.2d 1341 (D.C. Cir. 1971).

If allowed to stand, however, the Majority's decision will have a highly disruptive impact on wholesale markets and system reliability, it will devalue massive

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[52] Moreover, attempting to replicate demand response at the state level runs into many of the barriers that prompted FERC to act in the first place. These include a lack of utility and state government incentives to promote demand response, a long history of opposition to dynamic pricing, and collective action problems.

public and private investment in demand response, and it will undermine state policy and environmental goals, in contravention of the intent of the FPA. The strong policy reasons for not excluding demand response from wholesale markets support the conclusion that FERC did not abuse its discretion in fashioning its Rule to exercise jurisdiction over wholesale demand response.

### A. Restructured States Rely on Demand Response in Wholesale Markets to Provide Meaningful Price Signals to End-Users

The Joint States, as well as other states, have restructured retail electric markets. As discussed in Section IIA, electricity was historically supplied by vertically integrated electric monopolies that owned electric generation, transmission and distribution facilities. These vertically integrated monopolies were typically regulated by state Commissions, such as the Joint States, that set the rates the utilities could charge customers to provide all three services. *See New York v. FERC*, 535 U.S. 1, 5 (2002). In the 1990s several states, including Maryland and Pennsylvania, restructured their electric markets by requiring these vertically integrated monopolies to unbundle the charges for generation, transmission, and distribution services.[53] Significantly, the restructured states permitted the utilities to divest themselves of generation through the sale of such generation or through reorganization, and allow these new electric generation entities to compete against each other to

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[53] *See* Md. Code Ann., Public Utilities Article §§ 7-501 *et seq.* and 66 Pa. Cons. Stat. Ann. §§ 2801, *et seq.*

supply electric generation service to customers. By unbundling the generation and transmission services from state regulated utilities, Maryland and Pennsylvania, as well as other restructured states, have effectively sanctioned more direct customer interaction with the competitive wholesale energy market.

While customers in restructured states have more direct interaction to the competitive wholesale market, typical end-use customers pay a flat rate for each kilowatt-hour of electricity used, similar to the fixed rates paid when these services were a part of a vertically integrated monopoly. These markets continue to be suspended between the former vertically integrated regulated utility model and the as-yet-unrealized fully competitive market, in which both generation suppliers and end-use buyers have the information, infrastructure, and ability necessary to discipline each other through competitive market behavior. In a fully competitive market, end-use customers have the opportunity to see and to react to supplier bids. As wholesale and retail electric markets are still imperfectly integrated, and the price discovery infrastructure of electricity markets still strongly favors generation suppliers, the wholesale market continues to rely on a series of complex administrative price mechanisms to establish just and reasonable rates. Because of this imperfect and administratively complex structure, allowing customers to voluntarily participate in the wholesale energy market as demand response resources is a necessary step to establishing just and reasonable rates in the wholesale market.

Until the technology and market construct is developed to adequately and timely inform end-use customers of the true time and location-based price of electricity, voluntary demand response service participation in the wholesale energy market is the only mechanism currently available that provides appropriate and timely price signals to a meaningful number of end-use customers. Without such participation, the wholesale markets will increasingly favor generation, further impacting the efficiency and reliability of the wholesale markets.[54] FERC's regulation of customer participation in the wholesale electric markets, with state regulatory authority authorization, was appropriately limited to those customers who voluntarily agree to participate and narrowly tailored to address the impacts this participation has on the wholesale electric rate in accordance with FERC's authority under Section 206 of the FPA, 16 U.S.C. § 824e.

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[54] Demand response often provides the most cost-effective manner of bringing demand and supply into balance. FERC found: "It is widely accepted that dropping even a few megawatts off the system at peak periods is more efficient and economical than the incremental cost of generating them. Demand reduction offers a short-term and cost-effective means to provide additional resources during times of scarcity." *Removing Obstacles to Increased Electric Generation and Natural Gas Supply in The Western United States*, 94 FERC ¶ 61,272 at 61,972 (2001), 2001 WL 1842418 at *6.

### B. States Rely on Demand Response to Meet Environmental and Policy Goals

The Joint States (and other state commissions) also rely on demand response to meet legislatively targeted electric reduction and environmental goals. Demand response can provide numerous environmental benefits, including that it alleviates the need to build new generation or may displace older, less efficient and high-emissions producing power plants. Overall, it represents a cost-effective, environmentally friendly alternative to traditional generation.

In 2008, for example, Maryland's General Assembly passed the EmPower Maryland Energy Efficiency Act, which requires that the State's utilities achieve certain reductions in per capita electricity consumption as well as in peak demand. Specifically, the law requires a 15 percent reduction in per capita electricity consumption by the end of the year 2015 as well as a 15 percent reduction in per capita peak demand within the same timeframe.[55] Over the years, the implementation plans of the State's utilities have relied increasingly on demand response programs, offered through PJM's wholesale markets, to achieve their goals. The programs have produced substantial results, including total annualized energy savings of 4,549,782 MW-hours and total coincident peak demand reduction of 1,894 MW through 2015, accomplished, in part, from the 625

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[55] Maryland Code Annotated, Public Utilities Article § 7-211(b)(2).

MW of demand response that was bid into PJM by Maryland utilities in 2012 alone.[56]

Similarly, in 2008, the Pennsylvania General Assembly enacted Act 129 of 2008, P. L. 1592, No. 129, which required seven Pennsylvania electric distribution companies (EDCs) with at least 100,000 customers to reduce electric demand by a minimum of 4.5 percent in the 100 hours of highest demand by May 31, 2013. *See* 66 Pa.C.S. § 2806.1(d). It should be noted that these EDCs met this requirement with a combination of energy efficiency and demand response programs, without interference from the wholesale electric market.

In reliance upon federal-state cooperation regarding demand response, the Joint States (as well as many other state commissions) have spent billions of dollars to develop and deploy technologies necessary to enable a smart electric power grid.[57] Those investments

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[56] *See* Maryland PSC, EmPower Maryland Energy Efficiency Act – Standard Report of 2014 (March 2014), available at http://webapp.psc.state.md.us/intranet/Reports/2014%20EmPOWER%20Maryland%20Energy%20Efficiency%20Act%20Standard%20Report.PDF.

[57] For example, in 2008 Pennsylvania enacted legislation that required its large electric utilities to install smart meter technology, that, among other things, is to "effectively support automatic control of the customer's electric consumption by" the customer, the customer's utility or a third party engaged by the customer or utility. 66 Pa. Cons. Stat. § 2807(g). Similarly, the Maryland PSC has authorized extensive deployment of smart meters in the State, with more than 2.4 million of these meters already installed. *Re Baltimore Gas and Electric Company*, 101

include advanced automated metering infrastructure, in which digital technologies are applied to all aspects of the industry, from generation to transmission, to distribution, to the customer interface. Smart meters grant customers direct access to their hourly consumption, enable time-of-use rates, and support automatic control of electric consumption by the customer, the utility or, significantly, a third party, such as a curtailment service provider (CSP), engaged by the customer or the customer's utility. CSPs such as EnerNOC have also invested heavily in advanced metering infrastructure, in addition to their informational campaigns to inform customers of the availability and benefits of demand response. These enormous investments in smart meter technology have improved the ability of end-use customers to interact with energy markets and participate in demand response programs.

Overall, demand response programs offered through the states and used in conjunction with PJM's wholesale markets have enabled customers to reduce peak demand, thereby lowering retail electric prices and reducing the need for the construction of new generation resources, which even in compliance with the newest and most stringent standards, would have produced detrimental impacts on the environment. However, jurisdictional cooperation between the states and FERC are required for this to happen. For that reason, FERC's treatment of demand response in its wholesale markets represents cooperation between the federal and state agencies, and not an intrusion of

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Md. PSC 401 (2010), 2010 WL 3938140; *Re Potomac Electric Power Company*, 101 Md. PSC 448 (2010), 2010 WL 3981655.

federal authority upon state jurisdiction, as wrongly portrayed by the panel.

## IV. FERC'S DECISION REGARDING DEMAND RESPONSE COMPENSATION IS NOT ARBITRARY AND CAPRICIOUS

In the Majority Opinion, the D.C. Circuit incorrectly found that FERC failed to engage or consider Commissioner Moeller's arguments that the Rule would result in unjust and discriminatory rates. The Majority then inappropriately concluded that the Commission had not adequately explained how its adopted Rule results in just compensation. When reviewing the record evidence that FERC relied upon in adopting the regulation, it is apparent that the Majority inappropriately substituted its judgment for that of FERC.

To begin with, FERC's discretion to determine just and reasonable rates is broad. The FPA provides that FERC has authority to "determine the just and reasonable rate" by setting a level of compensation for demand response resources that will ensure that the rates charged in wholesale electric markets are "just and reasonable," and to "fix" rates, charges, and practices that are not just and reasonable. FPA section 206(a). FERC found that the rates and practices of RTOs and ISOs regarding demand response compensation were not just and reasonable to the extent that they inadequately compensate demand response that is capable of supplanting more expensive generation resources. Therefore, FERC acted within its discretion in determining a level of compensation for demand response that would fix the problem. *See* Dissent, (Pet. App. 23a), stating: "Having identified a

problem in the wholesale electricity market, the Commission has a statutory obligation to do what it can to fix it."

Additionally, it must be stressed that FERC allowed demand response resources to receive full LMP only when two specific conditions are met. *First*, the demand response resource must have the capability to displace a generation resource in a manner that balances supply and demand.[58] In other words, the demand response resource must supply a service substantially equivalent to the service provided by a generation resource to keep the electric grid in balance. Generation resources receive full LMP when they provide supply to balance the electric grid. Therefore, as FERC concluded, it is reasonable for demand response resources to receive the same full LMP when they balance the electric grid on the demand side, by reducing demand such that a generation resource is not called upon to balance the electric grid. Since FERC was defining a substantially similar service, balancing the grid, it is reasonable to pay each type of resource the same.[59] *Second*, the payment of LMP to a demand response resource must be cost-effective by passing FERC's "net benefits test." In other words, the benefits provided by using a demand response resource over a generation resource must equal or exceed the costs for

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[58] FERC Order No. 745 at ¶ 59, 2011 WL 890975 at *14.

[59] In fact, if FERC provided disparate payment for demand response and generation resources, it could be considered undue discrimination, in violation of the FPA. *See* FPA sections 206(a) and (b), authorizing FERC to remedy any rate, rule or practice that is "unduly discriminatory or preferential."

doing so. 134 FERC ¶ 61,187, 2011 WL 890975 *14 (Mar. 15, 2011). Ensuring that the benefits provided by a resource equal or exceed that resource's costs also demonstrates the reasonableness of the Rule.

Finally, FERC identified multiple barriers to demand response participation in the wholesale energy market, such as "the lack of a direct connection between wholesale and retail prices, lack of dynamic retail prices ..., the lack of real-time information sharing, and the lack of market incentives to invest in enabling technologies that would allow electric customers and aggregators of retail customers to see and respond to changes in marginal costs of providing electric service as those costs change."[60] FERC concluded that paying full LMP with the two conditions provided would address these identified barriers to demand response resource participation in the wholesale energy market. *Id.* Thus, contrary to the Majority Opinion, FERC adequately explained why the Rule would result in just and reasonable rates. The Commission also fully addressed Commissioner Moeller's argument that demand response resources would receive preferential treatment under FERC's Rule, stating "removing barriers to demand response participation is not the same as giving preferential treatment to demand response providers; rather, it facilitates greater competition, with the markets themselves determining the appropriate mix of resources."[61] As such, it appears that the Majority

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[60] FERC Order No. 745 at ¶ 57, 2011 WL 890975 at *16.

[61] FERC Order No. 745 at ¶ 59, 2011 WL 890975 at * 16. FERC also addressed Commissioner Moeller's argument that demand

inappropriately substituted its reading of the evidence and its judgment for FERC. *See F.C.C. v. Fox Television Stations, Inc.*, 556 U.S. 502, 513 (2009) (finding that a court reviewing an agency's determinations "is not to substitute its judgment for that of the agency and should uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned." (Internal citations omitted). The Joint States therefore support FERC's reasonable and fully-explained decision regarding the compensation to be paid to demand response resources under the Rule.

## CONCLUSION

For the reasons discussed above, Joint Parties respectfully request that the Court reverse the Majority decision of the U.S. Court of Appeals for the D.C. Circuit and find that FERC possesses authority to regulate wholesale demand response and that its decision regarding the compensation of demand response is not arbitrary and capricious.

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response resources could have an advantage because they already receive the benefit of forgone consumption, stating "examining cost avoidance by demand response resources is not consistent with the treatment of generation.... the Commission generally does not examine each of the costs of production for individual resources..." *Id.* at * 17.

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